

Message Text

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TO SECSTATE WASH DC IMMEDIATE 7503

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FOR EB KATZ FROM ENDERS

E.O. 11652: N/A

TAGS: OGEN

SUBJECT: DRAFT COMMODITIES SPEECH

FOLLOWING IS FIRST SECTIONS COMMODITY SPEECH. PLEASE REVIEW AND COMPLETE. SEND ME DATA AND CORRECTIONS BY IMMEDIATE CABLE TONIGHT. I WILL CALL FROM NEW YORK ON ARRIVAL TOMORROW.

1. IT IS CLEAR THAT THE LONG-RISING CONTESTATION BETWEEN DEVELOPING AND INDUSTRIAL COUNTRIES IS COMING TO A POINT OF CRISIS ON THE ISSUE OF RESOURCES. THE DEVELOPING COUNTRIES HAVE COME TO FOCUS ON CARTELIZATION, UP VALUING, INDEXING, REPOSSESSION OF RAW MATERIALS AS THE VEHICLE FOR THE REDISTRIBUTION OF THE WORLD'S WEALTH. IN DOING SO THEY HAVE COME UP AGAINST STRONG RESISTANCE FROM THE INDUSTRIAL COUNTRIES.

THREE THINGS ARE INVOLVED IN THIS CONTROVERSY: THE DIVISION OF WEALTH, THE EFFICIENCY OF THE WORLD ECONOMY, AND ITS FUTURE STRUCTURE. IT IS IMPORTANT TO BE PRECISE ABOUT EACH.

THE POTENTIAL SHIFT IN WEALTH, OTHER THAN IN PETROLEUM, IS LARGE IN ABSOLUTE TERMS, BUT NOT IN RELATION TO THE WORLD ECONOMY. THE DIFFERENCE BETWEEN THE SUCCESS AND THE FAILURE OF OPEC TO MAINTAIN A

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CARTEL PRICE FOR OIL MAY BE ON THE ORDER OF \$50 BILLION

A YEAR -- XX PERCENT OF THE NONCOMMUNIST WORLD'S INCOME. BUT OPEC IS UNIQUE IN THE CENTRAL ROLE OIL PLAYS IN WORLD PROSPERITY, AND IN THE INVERSE RELATION BETWEEN POPULATION AND PRODUCTION CAPACITY THAT GIVES THE CARTEL ITS STRENGTH. OTHER POTENTIAL CORROSIVE ACTIONS WOULD HAVE FAR LESS IMPACT. EVEN IF THE MARKETS OF ALL OTHER COMMODITIES PRODUCED PREDOMINANTLY IN THE DEVELOPING WORLD WERE TO BE CARTELIZED IN THE MANNER OF OPEC, WHICH THEY WILL NOT BE, THE GROSS GAIN TO LDC PRODUCERS WOULD BE ON THE ORDER OF \$XX BILLION A YEAR -- XX PERCENT OF WORLD INCOME. (JEFF: GET FROM HOLLIS CHENERY IN IBRD; HE DID A STUDY A YEAR AGO.) AND AS IN OIL, THE GAINS WOULD BE ERODED AS COMPETING SOURCES DEVELOPED IN CONSUMING COUNTRIES.

IN TERMS OF THE FUTURE EFFICIENCY OF THE WORLD ECONOMY, TWO THINGS ARE AT STAKE. FIRST IS THE MIS-ALLOCATION OF RESOURCES THAT CAN RESULT FROM WIDESPREAD CARTEL ACTION AND FOREIGN INVESTMENT DISPUTES AS PRODUCERS BUILD ADDITIONAL CAPACITY TO TAKE ADVANTAGE OF HIGH, ARTIFICIAL PRICES AND CONSUMERS SEEK TO INVEST IN ALTERNATIVE SOURCES IN AN EFFORT TO REGAIN MARKET POWER. THIS PROCESS IS ALREADY WELL ENGAGED IN THE CASE OF PETROLEUM, WHERE NEARLY 40 PERCENT OF OPEC CAPACITY IS IDLE, AND CONSUMERS ARE LAUNCHING MASSIVE INVESTMENT PROGRAMS. SOME XX PERCENT OF THE WORLD'S RAW MATERIAL SUPPLY (OTHER THAN FUELS AND FOOD) COMES FROM DEVELOPING COUNTRIES, OR \$XX BILLION A YEAR. INVESTMENT REQUIRED TO DUPLICATE SOME OF THESE SOURCES WOULD BE LARGE, BUT AGAIN NOT DECISIVE IN WORLD PERSPECTIVE.

SECOND IS THE DEGREE TO WHICH PRODUCTIVE CAPACITY IS USED. WE HAVE SEEN IN THE COMMODITY BOOM OF 1972-74 THAT THE WORLD DOES NOT HAVE ENOUGH CAPACITY TO SERVICE PERIODS OF PEAK DEMAND. INSTEAD, WE HAD TO ALLOCATE SHORT SUPPLIES THROUGH VERY HIGH SPOT PRICES AND QUEUING. THE DISTORTIONS IN THE INDUSTRIAL PRICING STRUCTURE AND IN PRODUCTION SCHEDULES WERE IN TURN COSTLY IN ECONOMIC TERMS. THE QUESTION NOW THAT THERE IS SUBSTANTIAL EXCESS PRODUCTION CAPACITY IN COMMODITIES LIMITED OFFICIAL USE

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IS WHETHER FUTURE PERIODS OF PEAK DEMAND CAN BEST BE SERVED BY BUILDING ENOUGH CAPACITY TO SERVICE THEM, OR WHETHER IT WILL NOT BE MORE EFFICIENT TO USE CAPACITY IN SLACK PERIODS TO BUILD STOCKS.

FINALLY, AND MOST IMPORTANT, THE CONTROVERSY OVER RESOURCES CAN MARK A TURNING POINT IN THE DEVELOPMENT OF THE WORLD ECONOMY. FOR OVER A GENERATION THE FASTEST

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GROWING COUNTRIES -- BRAZIL, MEXICO, IRAN, VENEZUELA, KOREA, MALAYSIA (JEFF: IS THIS A GOOD LIST?) -- HAVE BEEN THOSE THAT HAVE LINKED THEMSELVES MOST CLOSELY TO THE TRADE, TO THE CAPITAL MARKETS, TO THE TECHNOLOGY AND TO THE POLITICAL SYSTEMS OF THE INDUSTRIAL WORLD. IN THE PROCESS THEY HAVE CATAPULTED AHEAD OF THE OTHER DEVELOPING COUNTRIES, GROWING AT AN AVERAGE RATE OF XX PERCENT THESE LAST 20 YEARS AS AGAINST XX PERCENT FOR ALL DEVELOPING COUNTRIES. NOW THEY ARE BEGINNING TO CLOSE IN ON THE ADVANCED COUNTRIES. NEW FAST MOVING COUNTRIES ARE COMING IN BEHIND THEM.

SHOULD THERE BE A LARGE-SCALE CONFRONTATION -- A NORTH-SOUTH "CLASS WAR" ON THE ISSUE OF RESOURCES -- IT IS THIS PROCESS OF GRADUAL EXTENSION OF THE INDUSTRIAL SYSTEM THAT WOULD BE AT RISK. WHATEVER THEIR ECONOMIC INTERESTS -- SOME ARE LARGE-SCALE COMMODITY EXPORTERS, SOME NOT -- THE FAST MOVING COUNTRIES WOULD ALIGN THEMSELVES WITH THE BLOC OF DEVELOPING COUNTRIES. A COUNTER-BLOC OF INDUSTRIAL COUNTRIES WOULD FORM. THE DANGER WOULD BE THAT THE ECONOMIC LINKS BETWEEN THE TWO WOULD BEGIN TO SNAP. ALREADY FOR SOME YEARS ONE MEANS OF TRANSMITTING GROWTH FROM INDUSTRIAL TO DEVELOPING COUNTRIES -- COHCESSIONAL AID -- HAS BEEN STAGNANT. IT IS HARD TO SEE HOW THE OTHERS -- INCREASINGLY LIBERAL

ACCESS TO MARKETS, TO CAPITAL AND TO TECHNOLOGY -- WOULD NOT ALSO BE CURTAILED. THE RESULT WOULD BE SHARPLY MORE LIMITED OFFICIAL USE

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LIMITED GROWTH PROSPECTS FOR THE DEVELOPING WORLD AS A WHOLE.

THAT WOULD BE A MAJOR COST FOR THEM. BUT THERE WOULD ALSO BE MAJOR COSTS FOR THE INDUSTRIAL COUNTRIES. OUR PROSPERITY MIGHT BE LITTLE AFFECTED AT FIRST, ALTHOUGH WE WOULD BE SEPARATING OURSELVES FROM THE POTENTIALLY MOST DYNAMIC SECTORS OF THE WORLD ECONOMY. BUT OUR SENSE OF LEADERSHIP AND DYNAMISM IN THE WORLD WOULD GIVE WAY TO THE SIEGE MENTALITY OF A SMALL PRIVILEGED MINORITY IN AN INCREASINGLY ANTAGONISTIC ENVIRONMENT. IT IS DOUBTFUL THE INDUSTRIAL DEMOCRACIES CAN REALIZE THEMSELVES, UNLESS THEY REMAIN OPEN AND EXPANDING.

THERE ARE THUS MAJOR ECONOMIC AND POLITICAL PENALTIES TO BOTH DEVELOPING AND INDUSTRIAL COUNTRIES, SHOULD THEY FAIL TO FIND THE SOLUTION TO THE RESOURCES CONTROVERSY. BUT NO SOLUTION CAN SUCCEED, UNLESS IT CONFORMS TO THE UNDERLYING REALITIES, UNLESS IT CORRESPONDS TO THE INTERESTS OF BOTH PRODUCERS AND CONSUMERS, AND UNLESS IT IS PERCEIVED TO DO SO.

LET ME BEGIN BY A NUMBER OF REFLECTIONS ON THE NATURE OF THE PROBLEM. THOUGH I AM SPEAKING ESSENTIALLY OF COMMODITIES OTHER THAN FUELS AND FOOD STUFFS.

FIRST, ALTHOUGH WE MUST ALLOW FOR THE POSSIBILITY OF GROWING SCARCITY OF RESOURCES OVER THE NEXT 25 YEARS, IT WOULD BE WRONG TO BASE OUR APPROACH ON THE EXPECTATION OF SUCH A TREND. LIKE THE KOREAN BOOM A QUARTER CENTURY EARLIER, THE GREAT 1972-74 COMMODITY BOOM AWAKEHED FEARS OF CHRONIC SHORTAGE. WITHOUT QUESTION EACH YEAR LOWER-GRADE, LESS ACCESSIBLE, MORE MARGINAL AREAS AND SUPPLIES ARE BEING EXPLOITED. BUT OUR ECONOMIC HISTORY SHOWS THAT THE REAL CONSTRAINT IS CAPITAL INVESTMENT, NOT RESOURCE DEPLETION. TECHNOLOGICAL PROGRESS IN EXPLORATION, DEVELOPMENT, TRANSPORTING AND PROCESSING RAW MATERIALS HAS RUN FAR AHEAD OF DECLINING MINERAL RESERVES AND AVAILABLE LAND AND WATER. FOR A GENERATION AFTER THE KOREAN WAR, THE LIMITED OFFICIAL USE

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STEADY DECLINE IN COMMODITY PRICES IN TERMS OF MANUFACTURES-
SUGGESTED THAT THIS PROCESS IS STILL AT WORK.
THE BOOM OF 1972/74 MUST BE ATTRIBUTED ESSENTIALLY TO
THE SYNCHRONIZATION OF PEAK ACTIVITY IN ALL THE MAJOR
INDUSTRIAL ECONOMIES FOR THE FIRST TIME IN TWENTY YEARS.
BUT INADEQUATE INVESTMENT DURING THE LONG PERIOD OF
DECLINING PRICES MAY ALSO HAVE BEEN A FACTOR.

SECOND, IT FOLLOWS THAT THE KEY TO A SUCCESSFUL
INTERNATIONAL RESOURCES POLICY WILL BE INVESTMENT. IT
IS PROBABLE THAT THE INCREASE IN DISPUTES OVER PRIVATE
FOREIGN INVESTMENT IN RESOURCES IN DEVELOPING COUNTRIES
IS NOT AS GREAT NOR AS DAMAGING AS OFTEN FEARED.
SOME XX AMERICAN ENTERPRISES, REPRESENTING XX PERCENT
OF BOOK VALUE OF US INVESTMENT IN RESOURCES IN DEVELOP-

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ING COUNTRIES, WERE INVOLVED IN A DISPUTE IN THE YEARS
XX (JEFF: GET FROM JERRY GOLDSTEIN). MOST WERE SOLVED
BY AGREEMENT. BUT THERE IS NO DOUBT THAT PRIVATE
INVESTORS REGARD RESOURCE INVESTMENT IN MANY PARTS OF
THE WORLD AS MORE RISKY THAN PREVIOUSLY. NEW FORMS OF
ENTERPRISE: JOINT VENTURES, PRODUCTION-SHARING ARRANGE-
MENTS, LONG-TERM SUPPLY AND MANAGEMENT CONTRACTS HAVE
REPLACED TRADITIONAL CONTROLLING EQUITY INVESTMENTS
IN SOME SECTORS. BUT THESE DEVICES MUST BE DEVELOPED ON

A LARGE SCALE IF RESOURCE INVESTMENT IN THE DEVELOPING WORLD IS TO INCREASE IN THE FUTURE.

THIRD PRICE FLUCTUATIONS ARE COSTLY BOTH TO PRODUCERS AND TO CONSUMERS. FOR PRODUCING COUNTRIES HEAVILY DEPENDENT ON THE EXPORTS OF A FEW COMMODITIES, DEVELOPMENT PROGRAMS AND EVEN BASIC CONSUMPTION MAY BE HAVE TO BE ON A STOP/GO BASIS. FOR INDUSTRIAL COUNTRIES EXPORTING TO SUCH PRODUCERS, THE MARKET FOR THEIR PRODUCTS WILL BE CORRESPONDINGLY UNRELIABLE. BUT THERE ARE ALSO COSTS IN EFFICIENCY. WITH WIDE PRICE FLUCTUATIONS, INVESTMENT REQUIREMENTS AND PROFITABILITY ARE HARDER TO JUDGE. THE CHANCES AND PENALTIES FOR JUDGING WROHG WILL BE GREATER. INVESTORS WILL BE MORE CAUTIOUS, AND OVERALL INVESTMENT MAY GROW MORE SLOWLY. INDUSTRIAL CONSUMERS WILL BE UNCERTAIN WHETHER THE MATERIALS PROCESSES THEY EMPLOY AND INVEST IN WILL GIVE THE MOST ECONOMIC RESULTS, SINCE THE RELATIVE COSTS OF COMPETING LIMITED OFFICIAL USE

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MATERIALS MAY BE ALMOST IMPOSSIBLE TO FORECAST ACCURATELY.

ALL OF THESE EFFECTS ARE IMPORTANT, FOR THERE IS SOME REASON TO BELIEVE THAT PRICE FLUCTUATIONS IN COMMODITY MARKETS WILL BE GREATER IN THE FUTURE AS A RESULT OF THE SYNCHRONIZATION OF THE INDUSTRIAL ECONOMIES IN THE BOOM OF 1972/74 AND THE RECESSION OF 1974/75. ONLY WHEN SEPARATE BUSINESS CYCLES ARE AGAIN OUT OF PHASE WILL THE FLUCTUATIONS DAMPEN.

FOURTH, THE SOLUTION TO COMMODITY PROBLEMS CANNOT BE FOUND IN ATTEMPTS TO ESTABLISH HIGH FIXED PRICES AND TO MAINTAIN THEIR VALUE THROUGH INDEXING AGAINST PRICES OF MANUFACTURERS. IMPLEMENTATION OF SUCH A GENERAL INDEXING SCHEME WOULD REDISTRIBUTE INCOME CAPRICIOUSLY. IT WOULD TAKE INCOME AWAY FROM THE POOREST, MOST POPULOUS COUNTRIES IN THE WORLD, FOR THEY ARE NET IMPORTERS OF RAW MATERIALS. IT WOULD GIVE INCOME TO SOME OF THE RICHEST COUNTRIES: CANADA, THE USSR, AUSTRALIA, SOUTH AFRICA, FOR THEY ARE MAJOR NET RESOURCE EXPORTERS. INDEED, DEVELOPING COUNTRIES ACCOUNT FOR LESS THAN 30 PERCENT OF EXPORTS OF RAW MATERIALS OTHER THAN FOOD AND FUELS. ANY GENERAL SCHEME OF UP VALUING RAW MATERIALS IS THUS ALMOST BOUND TO DISTRIBUTE INCOME AWAY FROM THE DEVELOPING COUNTRIES AS A GROUP. EQUALLY IMPORTANT, IT WOULD RESULT IN LARGE-SCALE MISALLOCATIONS OF RESOURCES, WITH TOO MUCH INVESTMENT IN SOME COMMODITIES AND AREAS AND TOO LITTLE IN OTHERS, BECAUSE THE PRICE RELATIONSHIPS OF COMMODITIES

AMONG THEMSELVES WOULD HAVE BEEN FIXED AT A GIVEN POINT
IN TIME.

FIFTH, NO SOLUTION TO COMMODITY PROBLEMS IS VIABLE
WITHOUT A BALANCE OF MARKET POWER BETWEEN PRODUCERS AND
CONSUMERS. FOR STABILITY THE THREAT OF PRODUCER CARTELS
MUST BE OFFSET BY SUCH CONSUMER DEFENSES AS STOCK
PILES AND INVESTMENT IN ALTERNATIVE CAPACITY. IT IS
ALSO APPROPRIATE THAT IN CASES OF MASSIVE CONSUMER
BARGAINING POWER -- AS IN THE OIL MARKET IN THE 1950'S
AND 1960'S -- PRODUCERS COORDINATE TO OFFSET.
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